In the High Court of Punjab and Haryana, Chandigarh.

I.T.R. No.113 of 1997

Date of Decision: 5.4.2007

M/s Laxmi Pipes Pvt.Ltd., Hisar

…Applicant.

Versus

Commissioner of Income-tax (A), Rohtak

…Respondent.

CORAM: HON'BLE MR.JUSTICE M.M.KUMAR
HON'BLE MR.JUSTICE RAJESH BINDAL

Present: Mr.Akshay Bhan, Advocate
for the Petitioner-Assessee.

Mr.Yogesh Putney, Advocate
for the Respondent-Revenue.

JUDGMENT

M.M.KUMAR, J.

On the application made by the assessee, seeking reference of various questions of law arising out of the order dated 31.12.1996 passed in I.T.A. No.562/Delhi/92 in respect of assessment year 1989-90, the Income-tax Appellate Tribunal has referred only the following question of law for the opinion of this Court:-

> "Whether on the facts and in the circumstances of the case, the Tribunal was justified in holding that "loss" mentioned in clause (b) of the first proviso to Sub-section (1) of Section 205 of the Companies Act, 1956 read with Section 115J of the I.T. Act,

1961 does not include “unabsorbed depreciation”?

It is appropriate to mention that the assessee had filed its return declaring a loss of Rs.13,31,873/- including brought forward losses and allowances of Rs.10,79,986/-. The Assessing Officer disallowed deduction of earlier years' allowances by observing that there was no loss and placed reliance on CBDT circular No.495 dated 22.9.1987. However, the assessee had computed the book profit at minus figure of Rs.89,350/- after adjusting loss of Rs.5,23,490/- for the year ending on 31.12.1987. The Assessing Officer, however, computed the income of the assessee at 30% of the book profit of Rs.4,34,140/- at Rs.1,30,240/-. The Commissioner of Income-tax (Appeal) upheld the order passed by the Assessing Officer. On the second appeal filed by the assessee, the Tribunal upheld the view of the Assessing Officer and the C.I.T.(A) by observing as under:-

> “7.2 I have considered the order of the D.C.I.T and arguments of the ld. Counsel in the matter. The circular referred to by the D.C.I.T. Mentions that “36.3 Section 115-J, therefore, involves two processes. Firstly, an assessing authority has to determine the income of the Company under the provisions of the Income-tax Act. Secondly, the book profit is to be worked out in accordance with the Explanation to section 115J(1) and it is to be seen whether the income determined under the first process is less than 30 per cent of the book profit. Section 115-J would be invoked if the income determined under the first process is less than 30 per cent of the book profit. The Explanation to sub-section (1) of section 115J gives the definition of the “Book Profit” by incorporating the requirement of Section 205 of the Companies Act in the computation of the book profit. Brought forward losses or unabsorbed depreciation whichever is less would be reduced in

arriving at the book profit. Sub section(2), however, provides that the application of this provision would not affect the carry forward or unabsorbed depreciation, unabsorbed investment allowance, business losses to the extent not set off and deduction under section 80J to the extent not set off as computed under the Income-tax Act".

7.3 It would be obvious from the above that while working out the book profit, brought forward loss(es) or un-absorbed depreciation whichever is less would be reduced. It is admitted by the appellant that its brought forward loss was only ;after taking into account the depreciation. It means that the appellant did not have any actual brought forward loss except notional loss after reduction of depreciation. In view of this, the brought forward loss was, in fact, nil against substantial brought forward depreciation (both as per straight line method S.W.B.V. Method). As there was no business loss or the loss was less than the brought forward depreciation, the D.C.I.T. Was justified in not taking brought forward depreciation into account while working out the book profit. The section 205(b) of the Companies Act, referred to in above-said Board's circular is for the purpose of declaration/payment of dividend. The provisions contained in section 205(b) specify that where there has been loss in any previous year(s) the amount of the loss or an amount equal to the amount of depreciation provided for the year(s) whichever is less, should be set off against the profits of the year for which dividend is proposed. To give an example, suppose a company incorporated in 1980, has suffered in its first year a loss of Rs.1,00,000/- (including Rs.20,000/- by way of depreciation), in the second year, the company makes a profit of

Rs.50,000/- (after providing for depreciation). In this case, the Company may declare dividend upto Rs.30,000/- i.e. After deducting from profit the amount of first year's depreciation of Rs.20,000/- only. In other words, the Companies Act seeks to ensure that for the purpose of declaration of dividend, the book profits should be arrived at after taking the lesser of the amounts of brought forwarded loss(es) or depreciation. It would be evident that the Companies Act differentiates the actual loss and the loss after depreciation. In view of this, the appellant's contention that the loss in its case should be taken into consideration after providing for depreciation is not justified. In view of this, the actin of the D.C.I.T is confirmed.

8. In the result, the appeal is partly allowed".

Mr.Akshay Bhan, learned counsel for the assessee has argued that the controversy now stand concluded in favour of the petitioner by the judgment of Hon'ble the Supreme Court in the case of **"M/s Surana Steels Pvt. Ltd. v. Deputy Commissioner of Income-tax and others" 1999 (237) I.T.R. (SC) 777**. According to the learned counsel, the language of clause (b) of the proviso to Section 205(1) of the Companies Act, 1956, has been clarified by Hon'ble the Supreme Court by holding that it applies to those cases where the depreciation has been provided. According to the learned counsel, the depreciation is provided for in the profit and loss account. Therefore, the word "loss" as used in the proviso clause (b) to Section 205 signifies the amount arrived at after taking into account the amount of depreciation. In support of his submission, learned counsel has drawn our attention to last four paras of the judgment.

Mr.Yogesh Putney, learned counsel for the revenue has not been

seriously able to dispute the fact that the judgment of Hon'ble the Supreme Court in **M/s Surana Steels** (supra) would be wholly applicable and has decided the controversy in favour of the assessee.

After hearing the learned counsel, we are of the considered view that Section 115 of the Act was introduced in the assessment year 1988-89. It provides that if the assessee is a company and its total income determined under the Income-tax Act in respect of a previous year be less than thirty per cent of its book profit, fictionally it would be deemed that its total income chargeable to tax for the relevant previous year was an amount equal to thirty per cent of such book profit. The view of Hon'ble the Supreme Court on the issue reads as under:-

> "Once we have ascertained the object behind the legislation and held that the provisions of Section 205 quoted here-in-above stand bodily lifted and incorporated into the body of section 115J of the Income-tax Act, all that we have to do is to read the provisions plainly and apply the rules of interpretation if any ambiguity survives. Action 205(1), proviso clause (b) of the Companies Act brings out the unabsorbed portion of the amount of depreciation already provided for computing the loss for the year. The words "the amount provided for depreciation" and "arrived at in both cases after providing for depreciation" make it abundantly clear that in this clause "loss" refers to the amount of loss arrived at after taking into account the amount of depreciation provided in the profit and loss account. The significance of the formula prescribed in clause(b) of the proviso to Section 205(1) of the Companies Act can well be demonstrated by two examples as given hereunder:-

Example	Amount of profit/loss (Rs.)	Amount of depre-ciation provided (Rs.)	Loss for the year after taking into account the depreciation (Rs.)
1	(+) 1 lakh	3 lakhs	2 lakhs
2	(-) 1 lakh	3 lakhs	4 lakhs

In example 1, rupees three lakhs is the depreciation. Rupees two lakhs is the loss after taking into account the depreciation. The loss being lower than the amount of depreciation, it will be taken into account for set off against the profit of the year in which dividend is to be declared. In example 2, rupees three lakhs is the depreciation. Rupees four lakhs is the amount of loss after taking into account the depreciation. The depreciation being lower than the amount of loss, rupees three lakhs is to be taken into account for set off against the profit of the year for which dividend is to be declared. We are of the opinion that the term “loss” as occurring in clause(b) of the proviso to Section 205(1) of the Companies Act has to be understood and read as the amount arrived at after taking into account the depreciation. Then alone the formula prescribed in this clause would make sense and it would be consistent with the object sought to be achieved by enacting section 115J of the Income-tax Act, 1961. If “loss” were to be taken as pre-depreciation loss then the resultant computation will not be in conformity with the tenor of the provisions of Section 205. The language of clause((b) of the proviso to Section 205(1) is clear. It applies to those cases where the depreciation has been provided in accordance with the provisions of sub-section (1) of Section 205. The depreciation is provided for in the profit and loss account. The loss is arrived at

after taking into account the depreciation provided. It is therefore clear that the word “loss” as used in the proviso clause(b) to Section 205(1) signifies the amount arrived at after taking into account the amount of depreciation and it has to be so read and understood in the context of Section 115J of the Income-tax Act, 1961”.

When the facts of the present case are examined in the light of the principle laid down by Hon'ble the Supreme Court it transpires that the Tribunal has committed an error of law by refusing to take into account unabsorbed depreciation while working out the book profit. The Tribunal has also committed an error by holding that the loss cannot be taken into consideration after providing for depreciation whereas Hon'ble the Supreme Court has taken a contrary view. Therefore, the reference deserves to be answered in favour of the assessee.

In view of our above discussions, the reference is answered in favour of the assessee and against the revenue.

(M.M.KUMAR)
Judge

April 5, 2007 **(RAJESH BINDAL)**
dkb **Judge**